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what you need to know before you sell your life insurance policy

Research Brief #5

What is a reasonable broker's commission?

We won't presume to answer this question. The life settlement market needs more efficiency and disclosure, but it doesn't need price-fixing. We'll simply make a few observations to help you decide what is reasonable and what isn't.

The current state of the life settlement market

1. Life settlement brokers can provide services that are worth paying for. They prepare the documents that are needed to complete a life settlement transaction. They know the buyers in the market, and they can judge which buyers are most likely to make attractive offers. In some cases, they may be able to influence buyers to make higher offers.

2. Life settlement brokers often pay more than $1,000 for Attending Physician Statements and life expectancy appraisals. They lose this investment if there is no sale. It is common for brokers to incur expenses without making a sale more than half of the time. Each successful transaction has to cover the expenses incurred for the unsuccessful ones.

3. Life settlement brokers typically share their commission with the life insurance agent who brings the case. It is common for the agent to get up to two-thirds of the commission, even when the broker does most of the work. The agent also receives a commission when a new life insurance policy is purchased to replace the policy that is being sold.

4. Life settlement brokers may sometimes receive additional payments from life settlement providers. A similar practice by commercial insurance brokers has recently led to litigation, fines and unfavorable publicity.

5. It is common for brokers to charge a commission equal to 6% of the death benefit. If the commission is 6% of the death benefit and if the gross purchase price is 15% to 30% of the death benefit, then the commission is 20% to 40% of the gross purchase price.

6. It is instructive to compare the real estate market and the life settlement market. The average price of a house and the average price of a life insurance policy are similar. Both transactions involve finding buyers for a unique asset, and they both require a lot of paperwork. A standard real estate commission is 6% of the sales price, and there are discount services that charge a fraction of the standard commission.

7. Some life settlement brokers charge less than 6% of the death benefit. Some brokers charge a percentage of the gross purchase price rather than a percentage of the death benefit. Some brokers charge a percentage of the difference between the gross purchase price and the cash surrender value.

8. The incentives and disincentives of different commission structures have not been fully explored. The standard practice of charging a percentage of the death benefit seems bizarre, because the broker gets the same commission regardless of the purchase price. However, no approach is perfect. If the commission is a percentage of the gross purchase price, the broker gets rewarded if the policy has a high cash surrender value. If the broker's commission is based on the difference between the gross purchase price and the cash surrender value, the broker gets penalized if the policy has a high cash surrender value, even though the cash surrender value may not be a significant factor in determining the gross purchase price.

What you can do

9. Life settlement commissions are negotiable. The state anti-rebating laws that prevent the direct negotiation of life insurance commissions do not apply to life settlement transactions.

10. There is no law that prevents you from insisting on the full disclosure of the commission and any other payments received by the broker or referring agent that are directly or indirectly related to the life settlement transaction. If you want to know about potential conflicts of interest, you are free to ask. And if you can't get a straight answer, you are free to walk away. You own the asset, and when you walk away, the asset will go with you. Of course, if you don't want to take the actions that are necessary to protect your interests, you always have the easier option of letting other people take advantage of you.

11. You don't have to accept the commission arrangements that you find in today's life settlement market. You can create your own. For example, you can offer a base percentage of the purchase price plus an incentive fee for gross purchase offers that exceed a specified benchmark. You can decline to pay a commission on the portion of the gross purchase price that represents your cash surrender value, although to do this properly you would have to find out the impact of the cash surrender value on the gross purchase price.

12. In some states, a life settlement broker owes a fiduciary duty to the policyowner, by law. Fiduciary status implies a high standard of disclosure and accountability Brokers who have a fiduciary duty take a greater legal risk in engaging in unethical practices. You may want to take fiduciary status into account when you negotiate the commission.

13. If you are buying a new life insurance policy to replace the policy that you are selling, the life insurance agent will earn a commission on the new sale. You can treat the sale of the existing policy and the purchase of the new policy as one integrated transaction that generates a pot of money to compensate both the life settlement broker and the life insurance agent. Each piece of the transaction will depend upon the successful completion of the other piece, so the broker and agent will have an interest in working together. The division of the total pot between them will depend upon the actual circumstances.

14. Here's a short disclosure form to help you understand the compensation arrangements of brokers and referring agents: http://www.whatsmypolicyworth.com/wmpw_docs/wmpwdf1.pdf

Broker compensation practices will evolve as the life settlement market matures. Policyowners and their financial advisors can take an active role in designing compensation arrangements that reward brokers for acting in the best interests of policyowners.

Glenn S. Daily
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